No. 83-1111

IN THE

Supreme Court of the United States

October Term, 1983

HEUBLEIN, INC.,

Petitioner,

against

GENERAL CINEMA CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONER

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PRELIMINARY STATEMENT

In its brief in opposition to Heublein's petition, respondent General Cinema Corporation does not dispute the significance of the instant case (now unofficially reported at [Current] Fed. Sec. L. Rep. (CCH) ¶ 99,597 (2d Cir. Nov. 30, 1983)), and of *Texas International Airlines, Inc.* v. *National Airlines, Inc.*, 714 F.2d 533 (5th Cir. 1983), *petition for cert. filed*, 52 U.S.L.W. 3473 (U.S. Dec. 20, 1983) (No. 83-932), in applying Section 16(b) fo the increasingly important takeover area. Nor does General Cinema ad-

dress the confusion and needless litigation that will be engendered if the Second Circuit's decision is allowed to stand —engendered both by the Second Circuit's unwarranted extension of the "voluntariness" standard set forth in *Kern County Land Co. v. Occidental Petroleum Co.*, 411 U.S. 582 (1973), and by the disparate views expressed in the opinions below regarding how Section 16(b) liability can be avoided even though the defendant had actual access to inside information. The majority below read this Court's opinion in *Kern County* as permitting a defendant with such access to escape liability in certain classes of unorthodox cases, while the concurring Circuit Judge apparently determined that the defendant should escape on the basis of his conclusion that the information was not "material." Neither approach is consistent with *Kern County;* both approaches open the door to endless Section 16(b) disputes.*

ARGUMENT

The decision below extends *Kern County* to the point of hopeless confusion.

A. The application of a materiality standard is inconsistent with the *Kern County* rationale.

In *Kern County* this Court recognized that Section 16(b) is intended to prevent insiders from "exploit[ing] information not generally available to others." 411 U.S. at 592. The Court did not limit its holding, as General Cinema would have it, to "material" information. Mindful that in

* General Cinema devotes a good part of its brief to a discussion of the application to this case of the pragmatic analysis set forth in *Kern County*. The issue is not whether the pragmatic analysis applies but, if it does, whether it was applied properly.

garden variety cases the statute is a "flat rule," *id.*, the Court in *Kern County* held that, in unorthodox transaction cases, the opportunity for speculative abuse of inside information must be shown but proof of "actual abuse" of the information is not required. *Id.* at 595. Nor is proof of actual *receipt* of the information; a showing of "access" is enough. *Id.*

Congress wrote Section 16(b) broadly, and the liability it imposes is strict. The objective of avoiding problems of proof, set forth so clearly in *Kern County*, is crucial to the purpose of the statute. To require proof that the information to which the insider had "access" is "material" is completely at odds with this objective. Indeed, the majority below would apparently go even further: they would require proof that in the general "class of cases"—a concept nowhere clearly defined—there was likelihood of access to material inside information (4a-5a). Instead of reducing difficulties in proof, these approaches would only add enormously to them.

Other than in this case, no court has ever applied a "materiality" standard in determining Section 16(b) liability.*

* The District Court and Judge Van Graafeiland in the Circuit Court apparently based their conclusion that the information given to General Cinema was not material on a letter agreement between Heublein and General Cinema, pursuant to which inside information was provided to General Cinema, and which represented that the information Heublein provided was not the kind of information that would be required by law to be disclosed before General Cinema could make any further purchases or sales of Heublein stock. The letter was demanded by General Cinema to protect General Cinema against a subsequent suit by Heublein under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), to enjoin additional purchases of stock; it was not intended to have any bearing on a Section

(footnote continued on next page)

General Cinema's argument and the opinions below are utterly insupportable. The statute itself does not impose a materiality standard, and the legislative history establishes that there is none. The authorities are in agreement:

> "[T]he difficult problem that this Section [16(b)] avoids is the necessity of proving that the information was 'material'; such proof is required for recovery under the general fraud provisions of the Securities Exchange Act."

Weisen, *Disclosure of Inside Information—Materiality and Texas Gulf Sulphur*, 28 Md. L. Rev. 189, 195 (1968); *accord* 5 L. Loss, *Securities Regulation* 3003 (Supp. 1969).

The divergence that the Second Circuit has created on this issue will undoubtedly produce confusion among the lower courts in attempting to apply *Kern County*. It will lead to more litigation in two respects. First, in every unorthodox case there will be the potential of having to litigate the question whether a "materiality" standard applies. Second, in every case in which the approach taken by the Second Circuit is followed, there will necessarily be litigation over whether the standard has been met, either in the particular case or in the "class of cases" involved.

16(b) suit. As previously noted, the majority declined to determine that the information obtained by General Cinema was not material (4a).

Even if Section 16(b) were held to embrace a materiality standard, this letter cannot be considered as a waiver of Heublein's claim under Section 16(b) or as binding proof of lack of materiality, under the well-settled rule that the defenses of waiver and equitable estoppel are insufficient as a matter of law in Section 16(b) actions. *See* Securities Exchange Act of 1934 § 29(a), 15 U.S.C. § 78cc(a); *see also Newmark* v. *RKO General, Inc.*, 294 F. Supp. 358, 367 (S.D.N.Y. 1968), *aff'd*, 425 F.2d 348 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); 2 L. Loss, *Securities Regulation* 1041-42 (2d ed. 1961).

In view of the importance of Section 16(b) to the securities laws and the ever increasing number of mergers and acquisitions in the related litigation, it is important that this Court clarify for the lower federal courts whether and to what extent a materiality standard applies under the statute.

B. The "voluntariness" holding goes far beyond *Kern County*.

Contrary to General Cinema's contentions, the instant case greatly extends the concept of voluntariness which served as part of the basis of the hostile tender offer exception enunciated by *Kern County*. In holding that Occidental had no ability to control the course of events leading to the exchange of Occidental's stock in the Tenneco merger, and that its sale was thus "involuntary," the Court in *Kern County* relied on three factors: (1) the merger was not "engineered" by Occidental but actually sought by Old Kern; (2) the merger frustrated Occidental's real purpose, which was to gain control of Old Kern; and (3) Occidental had no influence over the course of events that resulted in the merger. 411 U.S. at 599-600.

In this case General Cinema has never denied that its purpose was to force a buy-out of its position at a premium and that, far from frustrating that purpose, the merger actually achieved it.* Thus, two of the three factors that controlled the "voluntariness" issue in *Kern County* are missing here. To the extent that there are circumstances going to show the third—an inability to influence the course

* These facts are not disputed, and no contrary findings were made below. Thus, the two-court rule has no application here. *Berenyi* v. *Immigration Director*, 385 U.S. 630, 635 (1967).

of events—the Second Circuit extended the test far beyond its articulation in *Kern County* by applying a "hands on" control standard, looking only at whether General Cinema participated in "arranging" or negotiating the terms of the merger, not whether it had some influence over the course of events that led to it.

Kern County did not address the influence Occidental may have had *prior* to the merger negotiations because, as a *bona fide* hostile tender offeror, Occidental obviously had none. Thus the finding that Occidental's exchange was "involuntary" does not shed any light on whether, as to this third element, General Cinema's exchange was "voluntary."

In *Texas International Airlines, Inc.* v. *National Airlines, Inc.*, *supra*, defendant was held to have "voluntarily" entered into a stock transaction under *Kern County*, even though it had failed to achieve its primary goal of taking over the target company and had no choice, as the potential holder of a large and powerless minority block, but to take some action to protect its own interest. Here, General Cinema's exchange was held to be "involuntary" under *Kern County*, even though it was never a tender offeror; had—according to the undenied allegations of the complaint—always wanted to sell its shares at a premium, not to gain control of the company; and had not only the choice but the specific design of selling its shares in the merger.

The lower courts are confused as to the meaning, purpose and proper application of Section 16(b) in the takover area. The Second Circuit in this case has added to the conflict and confusion. With ten years having passed since this Court's

decision in *Kern County* and mergers and acquisitions occurring in much greater numbers than they did a decade ago, this case and *Texas International* together present the opportunity for the Court to effectuate the intent of Congress as described in *Kern County* and to resolve the conflict and confusion among the lower courts.

February 10, 1984

Respectfully submitted,

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